

# Q&A ROUNDTABLE

A CONVERSATION WITH CTPARTNERS

## **A Look at What's on the Horizon for Chief Compliance Officers: How Financial Services Firms Can Ensure that They Recruit Professionals with the Right Compliance DNA**

In the financial services industry, it has always been accurate to describe the task of regulatory compliance as both thorny and time-consuming. Yet during the past few years, that task has become even more difficult and demanding, as chief compliance officers have needed to respond to regulatory standards and legal obligations that are at once numerous, diverse, evolving, and, in all too many cases, ill-defined. The outcome has been a rapid expansion of compliance functions within the financial services industry, and an increase in both the responsibilities and the stature of Chief Compliance Officers within their firms.

What are the recruitment and talent management implications of these developments? Recently, Glenn Buggy, a Partner in the Financial Services Practice at CTPartners, with expertise in the legal and compliance areas, met with business journalists Jill Fraser and Laura Walbert to explore these important issues.

**Q: Let's start with a basic question. What's behind this tremendous increase in regulatory oversight? Can it all be explained by the 2002 passage of Sarbanes-Oxley?**

**Glenn Buggy:** Sarbanes-Oxley is, in and of itself, an 800 pound gorilla. All public companies are governed by Sarbox, of course, but the nature of the financial services business makes the requirements deeper and farther-reaching for financial services than for a widget manufacturer. A widget manufacturer does not have to worry, for instance, about churning brokerage accounts or anti-money laundering laws.

Yet, Sarbox is not the sole culprit. There is quite simply a heightened sensitivity to the possibility of legal action from shareholders, state and federal regulators, and SROs (Self Regulatory Organizations). It's an evolution in the legal system. Even firms that face relatively few formal regulatory hurdles, such as hedge funds, often want a compliance officer in place to demonstrate the firm's serious treatment of ethical and compliance matters. Also, effective self regulation and disclosure is a great defense to mandatory regulation and disclosure.

**Q: So you've seen a growth in both externally imposed compliance requirements and internally imposed oversight standards, which are being applied as a protection?**

**Glenn Buggy:** Yes. That's to be expected when you consider that the downside to compliance and ethics matters is extremely serious. I can think of a case where questionable activities at a subsidiary are resulting in considerable fines for the parent company, not to mention the public black-eye. That's certainly not a unique situation. In a business based on trust and fiduciary relationships, risk to reputation is a primary concern. The punitive costs to a business can be devastating. And we all understand that a firm can be brought down by an ethics or fiduciary responsibility scandal.

But stepping back from the specifics relating to any particular corporation or industry niche, there's a larger reality that can't be overlooked. That's the reality that these trends are here to stay. Businesses must develop the compliance infrastructures – and along with that, the corporate cultures – that can respond to a strict and continuously evolving regulatory environment, not just in the U.S. but in regions across the globe. And there are clear talent management implications.

**Q: What do you mean by that?**

**Glenn Buggy:** Well, companies can, of course, retain consultants to assess their current oversight systems and exposures. These consultants may also assist with developing new policies and procedures for firm-wide implementation. An entire professional services business sector has evolved to serve clients motivated by fear of failure to comply.

However, responsibility for the execution of any plan, including filing of reports and follow-up initiatives to close performance gaps, all falls to the Chief Compliance Officer (CCO) and the compliance team. There's no outsourcing at that point. So building an expert and experienced compliance team is critical.

**Q: It's quite a challenge.**

**Glenn Buggy:** That's right. After all, there is a long laundry list of items that keep compliance officers awake at night. There is no such thing as solid ground, as the sands are always shifting. For example, the SEC and other regulators are once again questioning the appropriateness of charging mutual fund investors with so-called 12b-1 fees, which were approved by the SEC in 1980. Funds charging 12b-1 fees have to wonder if they will be allowed to continue to do so and, even more to the point, will they face fines or be painted as unethical for having utilized this fee structure?

Mutual fund CCOs, and their departments, must also climb a steep learning curve to meet new requirements and standards. In 2004, two new SEC rules went into effect, rule 206(4)-7 under the Advisers Act and Rule 38a-1 under the Investment Company Act, which require mutual fund companies and registered investment advisors to create and implement written compliance procedures. While we all appreciate that these requirements are not unreasonable, it can take a few years of reviews and assessment for a financial services firm to build and develop confidence in a new system.

**Q: Yet, when we discuss the compliance challenges facing financial services firms, they're scarcely confined to mutual funds – isn't that right?**

**Glenn Buggy:** Absolutely. In capital markets businesses, for example, there is the ongoing need to supervise the Chinese wall between the investment bankers, traders, and analysts to control and monitor any information flow between the various business arms of a firm. At some firms, compliance officers sit on the desk with the traders to proactively keep them out of the soup.

In investment management, internal trading activity by individual employees requires monitoring, and brokerage and investment accounts must be tracked. All business and trading relationships must be explored for inappropriate connections, such as too much trading with an old business school classmate, and so on. And the integrity of the firm's research must be guaranteed and protected from any potential conflicts of interest.

Meanwhile, the insurance field has long been complicated by the lack of national regulatory standards. Instead, insurers must meet the requirements of each state in which they operate. Most state-directed insurance regulations are similar, but how a state prioritizes the issues requiring investigation can vary.

Of course, ensuring the fair and ethical treatment of customers is a multi-faceted and critical task. Fee disclosure, the appropriateness of the fees, and the fee or commission being paid to any sales agent is a huge issue anytime you deal with an individual investor or wealth manager. The same is true when considering the suitability of investments.

**Q: How have developments like these changed the profile of a desirable Chief Compliance Officer for a financial services company?**

**Glenn Buggy:** There's been a real ramping-up when it comes to the kinds of skills and experiences that produce today's best-qualified CCOs. One way that I often describe it is by talking about the "modern compliance toolkit" that's now necessary.

Chief Compliance Officers need to, of course, be completely up-to-speed on all kinds of developments relating to our post-9/11 world. Consider the Patriot Act and anti-money laundering requirements -- pre-9/11, the government's list of persons of interest was only a fraction of what it is today. The complexities are endless. We are just seeing the first significant wave of investigations and audits by the IRS and other regulators related to money-laundering.

CCOs need to make certain that their firm's protections and procedures are everything they should be. And, of course, they must be able to carry out these policies, which is what I call "managing by influence." After all, compliance programs only work the way they should when there's real buy-in throughout the company. An effective compliance culture is one that does not perceive the compliance professionals as the people wearing the black hats. A good CCO will build a team of value-added professionals to execute and enforce the compliance agenda cooperatively with the businesses. The best Chief Compliance Officers have established credibility within their companies and among the various regulators responsible for oversight of the particular market segment.

**Q: Executives who possess those skills must be in great demand.**

**Glenn Buggy:** They are, and there's no doubt that the recruiting environment for CCOs has changed in recent years. Compensation demands are higher than they once were. Where there's a higher perceived risk, as in the capital markets, the compensation packages are highest. Asset management firms tend to pay more for CCOs than do insurance firms, but there are always exceptions. And it's interesting to see that some firms are structuring their pay packages differently, which might include salaries without an equity component, to eliminate any hint of a conflict of interest. Others do not make that distinction.

**Q: In addition to their compensation, have Chief Compliance Officers seen their roles shift in other ways too?**

**Glenn Buggy:** Yes. At many financial firms, CCOs are now overseeing large compliance departments, often spanning the globe, which demands management skills that may not have been required of compliance officers in the past. I can think of situations where large diversified financial services firms did not even have a centralized compliance function five or six years ago; the firm's total compliance staff might have consisted of a handful of people. Now at these same firms, the CCO might be supervising 100 people around the world.

Yet there's no one-size-fits-all formula for an effective compliance department, which is one reason why this job requires such a high level of expertise. The chain of command varies greatly from firm to firm. Some CCOs report directly to the CEO and in other cases the CCO reports to the General Counsel. And some firms have a stand-alone compliance function that reports only to the board of directors.

**Q: Do organizational differences like these have recruitment and talent management implications?**

**Glenn Buggy:** Absolutely – and the right search partner will be attuned to these matters, to make certain that the right candidates are being considered. For example, a compliance function reporting to the General Counsel is more likely to be staffed with lawyers. One of the challenges that CCOs often face is that their field compliance officers will report to local business unit managers, rather than directly to the CCO; that impacts hiring and management choices as well.

In addition, to ensure consistent behavior throughout the many offices of a large firm, the CCO must set up a self-policing process

that anticipates areas of concern, one that is proactive rather than reactive. CCOs and their teams must be capable of and committed to repeated compliance reviews, so as to gauge the effectiveness of current policies.

**Q: Can you tell us about the people who are filling these compliance roles? What background is needed?**

**Glenn Buggy:** Compliance has always drawn heavily from the legal world. However, compliance officers don't have to be attorneys; they can be former accountants, traders, portfolio managers, or analysts. Effective compliance professionals understand the full process of the business – where things can go wrong; how one decision can initiate a domino effect. One veteran Chief Compliance Officer told me, "It's important to know how the sausage is made." Tapping talent from all of these areas is key as firms recognize the need to build bench strength in the compliance area. These bench positions can offer a promising career path for the next generation CCOs. Compliance officers receive quite a bit of training regarding regulatory specifics – and in some sectors are required to obtain regulatory licenses - so the primary goal is to hire smart, detail-oriented people who can interpret and apply rules.

My colleagues and I at CTPartners find it can be useful to recruit senior people out of government roles, from the SEC, the Treasury, even the IRS; as well as SROs. Individuals who have had experience with regulatory bodies, who understand the thinking of those bodies are paid a premium, and can be very valuable. Those who have that regulatory background and industry experience are even more coveted.

**Q: With greater demands on Chief Compliance Officers and more competition for the best-qualified candidates, how can the right search partner make a difference for a financial services firm?**

**Glenn Buggy:** When we're talking about CCOs and other senior compliance professionals, I believe that there are two important ways to answer that question. In any search, it's essential for an executive recruitment firm to have access to a pool of the best-qualified candidates and to be able to carry out searches quickly and effectively. At CTPartners, we have developed a collaborative team approach which we believe is especially successful in reaching and recruiting top-quality CCOs. This approach draws upon my own 12 years of specialization in compliance and legal recruiting within the financial services industry and my prior years practicing corporate law. Additionally, I collaborate with colleagues who are specialists in other areas of the financial services marketplace, such as asset & wealth management, capital markets, investment banking, insurance, etc. That creates a powerful synergy which brings real benefits to our clients.

There's one other issue that I believe is of great importance to CCO searches. With a position like this one, which relates first and foremost to matters of corporate integrity, the right search partner will always be a firm of high ethical standards. At CTPartners, we are committed to a culture of transparency and accountability, with an audited 2006 successful placement rate that is the highest in the industry. That same year, we became the first executive recruitment firm in the industry to measure its candidate stick rate of 94%. Within Financial Services, the stick rate was 97%. I believe that such firm-wide practices create real synergy with clients in search of the right compliance executives.

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